

Fallouts of RBI's Tightening Regulatory Grip

What is the issue?

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• In the coming weeks, many banks in India are expected to report weak results.

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• This is expected on account of the fact that there is a progressive tightening of rules for rules in dealing with bad loans.

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Why did RBI tighten the rules regarding NPAs?

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- There is a palpable economic slowdown in the last couple of years and many borrowers are unable to repay their debts.
- As bad loans piled up, a progressive tightening of rules was unleashed by RBI to address the NPA problem since 2015.
- Incidentally, this has effectively curtailed the discretion of banks and borrowers to reach a negotiated settlement – which is prolonging resolutions.

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 Historically, any loan that has seen a default of over 90 days is classified as a bad loan in India and procedures to deal with them has largely been lenient.

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 But rules had to be tightened, as there has been a reluctance to address the issue head-on because of pressure from influential borrowers and PSU banks.

• This tightening of rules, has meant stumping up of more cash, lower

profits, and restrictions on the ability to lend more. n

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What were the specific tightening measures?

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 The new insolvency law that come into force in 2016, and growing outrage against instances of corporate fraud have left banks bleeding.

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 In February, RBI did away with several schemes such as Strategic Debt Restructuring (SDR), which allowed banks to grant extra time to borrowers.

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- Rules to classify a loan as 'bad' or a 'Non-Performing' was tightened to mark even a day's slippage which got all stakeholders worried.
- But despite these concerns the banking regulator (RBI) has stayed firm in its dictacts by holding that the sanctity of debt agreements needs to be restored.

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• Many have argued that this approach would cramp lending by banks at a time when most indicators show that growth is on the upswing. $\ensuremath{^{\backslash n}}$

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Is RBI's zeal for addressing the bad loans hurting growth?

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 The RBI Governor Raghuram Rajan had stated in unambiguous terms that clean up definitely deserves higher priority for fixing the economy.

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- \bullet There seems to be consensus to this view among all of RBI's higher ranking officials and their policy direction is clear. $\mbox{\sc h}$
- Hence, RBI is consciously overlooking the fact that credit supply in the economy is reducing, which will definitely have consequences for

growth.

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 Notably, RBI has publicly acknowledged that its lax attitude towards bad loans in earlier, is what has lead to the current NPA burden of Rs.8.9 lakh crores.

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What are the lessons from elsewhere?

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- \bullet Most other economies have also resorted to tighter banking regulations to tide over the bad loans problem. $\mbox{\ensuremath{\backslash}} n$
- A tougher operational environment has inevitably led to conflicts between the banking regulator and the owners (It is predominantly PSUs in India).

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- Some tensions in this regard are already visible between the RBI and Government, but there have also been some positive spin-offs too.
- A palpable behavioural change has been observed among some borrowers as promoters fear an aggressive bank takeover if they fail to service their debts.

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• Notably, post the 2008 financial crisis, banks in the West have also been subject to rigorous standards and changes of rules. $\ensuremath{^{\backslash n}}$

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How does the future look?

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- A system that doesn't disrupt the economy, but still delivers for it and rules need modifications to suit situations.
- And when risk-taking increases, it must not be at the expense of the resilience of banks to any future downturn in the economy.

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 For policymakers, balancing growth imperatives with regulations is a difficult choice to make as it requires political stamina to pursue long timelines.

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 Ridding banks of bad loans and cleaning up balance sheets are a very critical that requires prudent and active policy engagements to tide the cliff.

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- In India's case there is a greater risk of budgetary allocation being pumped in for aiding public banks during distressing times.
- \bullet Hence, solving the entire mesh of issues hinges not only on financial sector practices but across all economic domains. $\ensuremath{^{\backslash n}}$

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Source: Indian Express

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